

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

Date: MAY 25 2000

Contact Person: [REDACTED]

ID Number: [REDACTED]

Telephone Number: [REDACTED]

NO POSTEST RECEIVED
Release copies to DASH

Date [REDACTED]
Surname [REDACTED]

000

Employer Identification Number: [REDACTED]

Dear Applicant:

We have considered your application for recognition of exemption from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). Based on the information submitted, we have concluded that you do not qualify for exemption under that section. The basis for our conclusion is set forth below.

You were incorporated in the State of [REDACTED] on [REDACTED]. Your Articles of Incorporation were amended on [REDACTED] and state that your purpose is to provide financial assistance for other section 501(c)(3) organizations and to provide education in investment wherein individuals may better their lives and their communities.

Your application indicates that you were "created to take donations and invest them in the commodities markets. Profits generated will be used to assist other 501(c)(3) organizations and also will be reinvested to generate additional capital. The goal is to use our marketing skills so that other 501(c)(3) organizations will receive a greater benefit than what the original donation by itself could give." On your Form SS-4, Application for Employer Identification Number, you have characterized your business as an investment corporation. You further state that you will provide training to youth during the summer to expand their opportunities for careers, and increase their personal development and self worth.

Your activities are to be conducted by your four directors, [REDACTED], [REDACTED], [REDACTED], and [REDACTED]. According to your application, these directors have been studying the commodities markets for the past four years using a variety of books and have been practicing investing using practice market trading software. You do not indicate whether any of your directors have any specialized expertise nor have you submitted any evidence that they have conducted a successful commodities purchasing program or have any experience in the field at all. When asked for resumes, you declined

[REDACTED]

to provide them. You also stated that currently none of your directors are paid but that in the future, you may consider compensation.

On your Form 1023, you indicate that your support will come from contributions from the general public and from the reinvestment of proceeds from market transactions. Initially, you have indicated, that contributions will be coming from your directors and individuals whom they know. You plan to develop a formal fundraising plan at a later date. You state that you will be a private foundation as defined in section 509 of the Code.

The financial data you submitted indicates that you expect returns on your investments to run well over one hundred percent (100%). In fact, in fiscal [REDACTED], you plan to invest \$[REDACTED] and generate investment income of \$[REDACTED]. In [REDACTED], with an additional \$[REDACTED] contribution, you predict investment income of \$[REDACTED].

In your letter of [REDACTED] you expanded on your investment tactics. You stated that your "primary activity will be the buying and selling of future contracts in the commodity markets. Future contracts will be purchased at a low value and sold back at a high value as the market changes to build income. Vice-versa future contracts will be sold at a high value and bought back at a low value for income. The same concept applies to commodity options which we will also be trading in." As your example indicates, if you judge the market correctly and the price of your commodity rises, you will make a profit. You haven't addressed what happens when the price falls.

Your letter also indicates that after your program becomes successful and you have sufficient funding, you plan to teach your investment method to youth during the summer. In this regard, you plan to hold a 3 to 5 day course at a local community center to teach introduction to markets, market behavior, and investment strategies. Your directors will be teaching this.

In response to our question regarding your charitable program, you state: "We do not currently have a specific list of organizations to whom we will be donating to. We will be open to review request from any 501(c)(3) organization."

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(a)(1) of the Income Tax Regulations states that, in order to be exempt as an organization described in section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more of the purposes specified in such section. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages

[REDACTED]

was that all of its profits were required to be paid to the church. Since the organization had no other significant charitable activity and its principal income producing activity was the conduct of a trade or business, the Service held that the organization was not exempt under section 501(c)(3) by virtue of section 502.

Randall Foundation v. Riddell, 244 F.2d 803 (1957), discusses an organization similar to you. The organization was created for the promotion and advancement of charitable, religious, and educational projects on a non-profit basis. No member was to have any proprietary interest in its assets or income and upon dissolution, its assets were to be distributed to charitable organizations. The original Board of Trustees consisted of Paul Randall and members of his family. The capital of the Foundation consisted of contributions made to it by Paul Randall who also managed the funds. The Foundation traded in securities, most of which were oil stocks listed on the Los Angeles Stock Exchange, and made substantial profits through multiple trades. This investment activity was the primary activity of the Foundation. Only one charitable contribution was made at the end of each fiscal year.

The court affirmed the Service's conclusion that the Foundation did not qualify for exemption under section 501(c)(3) of the Code because it was not organized and operated for exclusively exempt purposes. Although there was no showing that any part of its net earnings inured to the benefit of any particular shareholder or individual, the Foundation was engaged in a highly speculative business. The business transactions were its sole reason for existence. The court noted that the Foundation's transactions in securities were substantial and frequent. It was not engaged in an occasional or isolated venture. As these transactions constituted almost the only activity, the Foundation was operated as an organization engaged in conducting an investment business for profit. The court stated that the Foundation could not become a charity simply by announcing that it intended to devote its profits to charity. The corporation was competing with others in the market place, in a speculative business in which the whole principal and profits might be wiped out. It had only a vague charitable design and was not described in section 501(c)(3).

In stating that the operation of a business for profit is not an exempt purpose, the court affirmed the principal that the ultimate destination of funds is not the sole determining factor when considering whether an organization qualifies for exemption under section 501(c)(3) of the Code. The nature of the organization's activities must be carefully scrutinized to establish that it is exclusively operated for charitable purposes. See, Ralph H. Eaton Foundation v. Commissioner, (9th Cir.) 219 F.2d 527. The court also pointed out that when the money of a corporation is mingled with that of other persons and used, even in part, year after year for speculative and business ventures, the risk of loss must be considered. Money is not used for charitable purposes when it is traded in a speculative venture. See, John Danz Charitable Trust v. Commissioner, (9th Cir.), 231 F.2d 673.

Rev. Rul. 64-182, 1964 (Part 1)-1 C.B. 186, describes an organization that derived its income principally from the rental of space in a large commercial office building that it owned, maintained, and operated. The ruling holds that the organization meets the primary purpose test of section 1.501(c)(3)-1(e) of the regulations because its charitable contributions are commensurate in scope with its financial resources and are in furtherance

In Better Business Bureau of Washington, D.C., Inc. v. United States, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy a claim for exemption regardless of the number or importance of truly exempt purposes.

Section 1.501(c)(3)-1(c)(2) of the regulations provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. The section cross references the definition of private shareholder which is contained in section 1.501(a)-1(c). That section provides that the words private shareholder or individual in section 501 refers to person having a personal and private interest in the activities of the organization.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations states that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirements of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Rev. Proc. 90-4, 1990-2 I.R.B. 10, at section 7 provides that the Service may decline to issue a ruling or a determination letter whenever warranted by the facts or circumstances of a particular case.

The basic principal to be derived from the above discussion is that organizations engaged in ordinary commercial ventures to raise funds for exempt organizations are not performing a charitable function, per se, and are not themselves exempt. Your goal of raising funds for charity may be well intentioned but your activities serve no independent exempt purpose. You do not operate a trade or business in furtherance of exempt purposes as required by section 1.501(c)(3)-1(e) of the regulations, rather you operate the business for the sole purpose of making a profit and distributing it to one or more exempt organizations. You, like the organization described in Randall Foundation v. Riddell, supra, plan to engage in a speculative business venture, trading on the commodities market, to generate profits. You have no charitable grant making program. You have indicated that grant making procedures will be adopted when you show a profit. However, the type of investment activity you describe is very risky, it is, in fact, similar to gambling with charitable dollars. The risk of loss is substantial and you may never have any funds to use for charitable purposes. Accordingly, we conclude that you have not established that you

[REDACTED]

are operated exclusively for exempt purposes within the meaning of section 501(c)(3) of the Code and section 1.501(c)(3)-1(c)(1) of the regulations.

In addition, even if we determined that you were operated for an exempt purpose, your sole activity is the operation of a business for the sole purpose of making a profit and distributing it to one or more exempt organizations. In this regard, you are similar to the organizations described in Rev. Ruls. 54-305 and 73-164. Your only basis for exemption is that the beneficial use of your assets is effectively dedicated to charitable objects in that all your profits are to be used for charitable purposes. Exemption under section 501(c)(3) would be precluded by virtue of section 502.

You are also not similar to the organization described in Rev. Rul. 64-182. You are engaged in a business that would be considered an "unrelated trade or business" under section 513 if you provided services to unrelated organizations. In addition, you do not have a program that furthers charitable purposes because you do not plan to make any charitable contributions until and unless you realize substantial profits from the business. It is not possible for us to conclude without further information that you will engage in a program of charitable giving commensurate in scope with your financial resources.

Based on the information you submitted, we conclude that you are operated for the primary purpose of operating a business for profit. Any charitable purpose you may serve is vague and secondary. This is a non-exempt purpose that is substantial in nature and precludes exemption under section 501(c)(3) of the Code. See, Better Business Bureau, supra. You have not established that you are operated exclusively for purposes described in section 501(c)(3) of the Code. Therefore, it is our conclusion that you do not qualify for recognition of exemption as an organization described in section 501(c)(3) of the Code.

Contributions to you are not deductible under section 170 of the Code.

You must file federal income tax returns on Form 1120 as a business corporation.

You have the right to protest this ruling if you believe it is incorrect. To protest, you should submit a statement of your views to this office, with a full explanation of your reasoning. This statement, signed by one of your officers, must be submitted within 30 days from the date of this letter. You also have a right to a conference in this office after your statement is submitted. You must request the conference, if you want one, when you file your protest statement. If you are to be represented by someone who is not one of your officers, that person will need to file a proper power of attorney and otherwise qualify under our Conference and Practices Requirements.

If you do not protest this ruling in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Code provides, in part, that a declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the United States Court

[REDACTED]

of Federal Claims, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within 30 days, this ruling will become final and a copy will be forwarded to the Ohio Tax Exempt and Government Entities (TE/GE) office. Thereafter, any questions about your federal income tax status should be directed to that office, either by calling 877-829-5500 (a toll free number) or sending correspondence to: Internal Revenue Service, TE/GE Customer Service, P.O. Box 2508, Cincinnati, OH 45201. The appropriate State Officials will be notified of this action in accordance with Code section 6104(c).

When sending additional letters to us with respect to this case, you will expedite their receipt by using the following address:

Internal Revenue Service
[REDACTED] T:EO:RA:T:4 Rm. 6236
1111 Constitution Ave, N.W.
Washington, D.C. 20224

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Gerald V. Sack
[REDACTED]

Gerald V. Sack
Manager, Exempt Organizations
Technical Group 4

[REDACTED]

[REDACTED] [REDACTED]